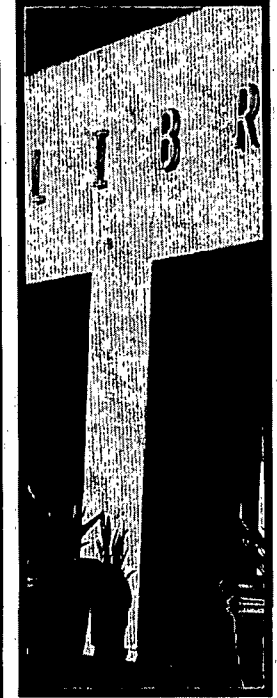
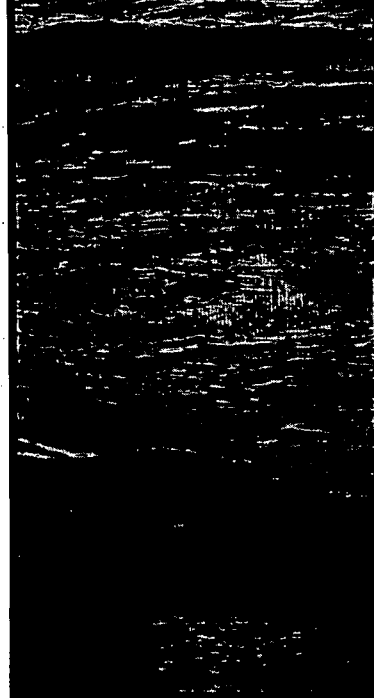
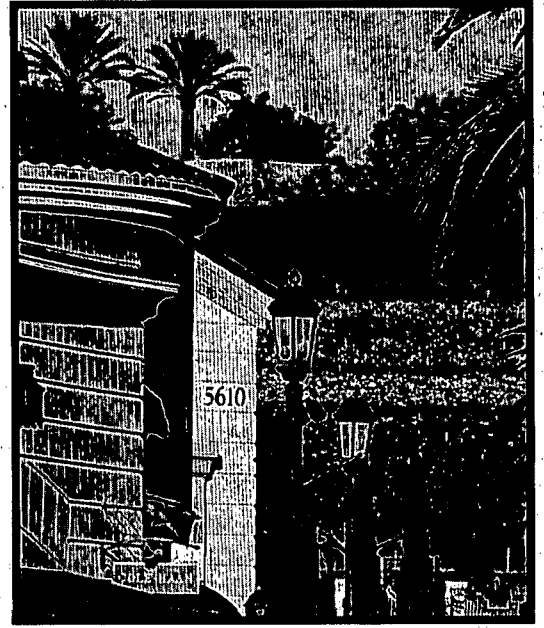
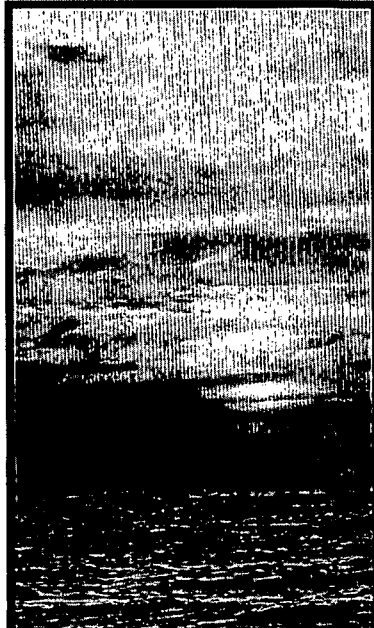


City of CARLSBAD California



C r e a t i n g a S u s t a i n a b l e C o m m u n i t y

2006-2007

**PRELIMINARY OPERATING BUDGET &
CAPITAL IMPROVEMENT PROGRAM**



City of Carlsbad 2006-07 Preliminary Operating Budget and Capital Improvement Program

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CITY OF CARLSBAD, CALIFORNIA 2006-2007 PRELIMINARY BUDGET

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Carlsbad City Council

2006

Five-Year Vision Statements



City Council continues to clarify and pursue the vision of Carlsbad that reflects the pride and quality of life for all who live, work, and play here.

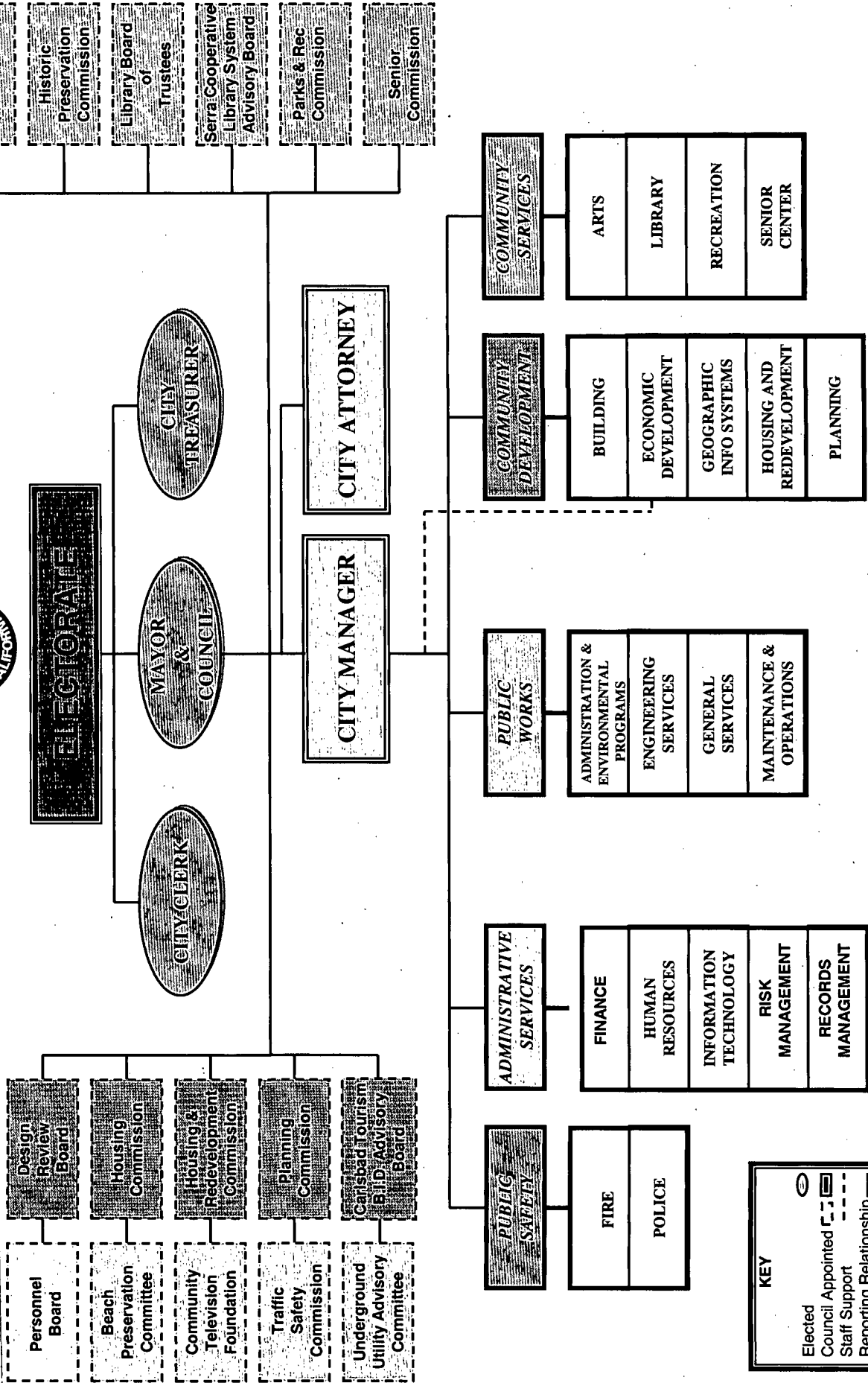
Carlsbad . . .

- Provides a diverse and healthy economic base that creates opportunities for employment to the residents of Carlsbad, economic vitality to the community, and the necessary revenues to support City services.
- Provides programs, policies and decisions to implement the General Plan, enforce the Growth Management Plan, maintain the safety and security of its citizens, and are based on what is best for Carlsbad.
- Occupies a leadership role in local and regional planning, (e.g., water, beach, circulation, and environmental issues) important to local governments and is actively involved addressing governmental issues at the local, state and national levels.
- Provides an open government leading to the betterment of the community and encourages in a non-partisan manner active citizen participation and involvement with the City Council and the City's Boards and Commissions.

And Carlsbad Efficiently and Effectively...

- Delivers top-quality public services.
- Manages its environment proactively, including:
 - ◇ Open space
 - ◇ Wildlife habitats
 - ◇ Water quality/conservation
 - ◇ Beach preservation
 - ◇ Air quality
 - ◇ Resource conservation and waste reduction
- Promotes a safe and efficient integrated transportation system.
- Maintains citywide "small town" community spirit.
- Provides a community where continuous and life-long learning is supported and encouraged for people of all ages.
- Looks ahead and works to anticipate changes that are required now in order to make a better future for its citizens.

CITY OF CARLSBAD ORGANIZATION CHART



KEY

- Elected
- Council Appointed
- Staff Support
- Reporting Relationship
- Programs



CITY OF CARLSBAD

2006-07 PRELIMINARY BUDGET

Carlsbad is a full-service City providing the following:

- Police department
- Fire department, including paramedic
- Water delivery system
- Sewer system
- Solid waste services
- Housing programs
- Development services
- Street construction and maintenance
- Library and Arts programs
- Recreation programming for all ages
- Park lands

School programs and facilities are provided by four different school districts located within the City boundaries. Although the City Council has no direct control over these school districts, the Council recognizes the importance of quality school facilities and programs to Carlsbad's residents. The Council has worked closely with the schools in the past, and staff continues to meet with them on a regular basis.

BUDGET PROCESS

The budget process for the City of Carlsbad begins in January each year, with a review and update of the City Council's five-year vision statements. Through the vision statements, Council defines and clarifies their vision of Carlsbad. The City Council also provides the City with their top 15 priority projects, which further defines their vision. The strategic goals for the City are developed next. These statements are reflected in the box on the right. The goals further define the methods used to achieve the vision and call out areas in which Council would like to place special emphasis during the year. Once these are developed, staff develops operational goals based on Council's direction. These operational goals are the basis for the development of the Operating Budget.

City of Carlsbad Strategic Goals

Balanced Community Development - A city that connects community, place and spirit, through balanced and economically sustainable land uses.

Citizen Connection And Partnership - A city that embraces Community connectivity through the effective use of technological and interpersonal mediums.

Communication - Ensure that community members, Council and staff are well informed, continuing to be a more responsive government while providing a high level of citizen confidence in its government.

Environmental Management - An environmentally sensitive community by focusing on: conservation, storm water, sewage collection and treatment, solid waste, and cost effective and efficient use of energy including alternative energy sources.

Financial Health - Pursue and implement proactive strategies that support sustainable economic health and manage fiscal resources effectively.

Learning, Culture & Arts - Promote and support continuous learning, cultural opportunities and the arts within the community and the City organization.

Parks / Open Space / Trails - Acquire, develop and maintain a broad range of open space and recreational facilities that actively address citizen needs which are fiscally responsible, and are consistent with the General Plan and Growth Management Standards.

Top Quality Services - A city that provides exceptional services on a daily basis.

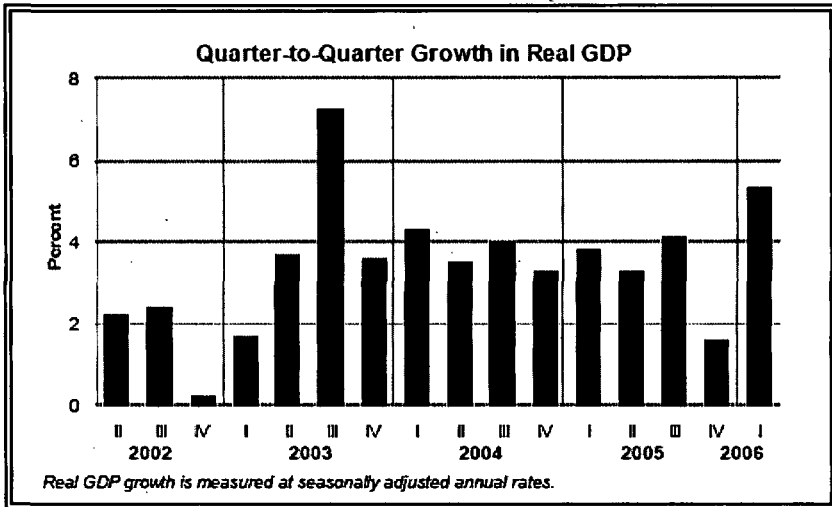
Transportation / Circulation - Provide and support a safe and efficient transportation system that moves people, services and goods throughout Carlsbad.

Water - Ensure, in the most cost-effective manner, water quality and reliability to the maximum extent practical, to deliver high quality potable and reclaimed water incorporating drought-resistant community principles.

Carlsbad's Operating Budget is a tool that guides the achievement of Council's vision, goals and priority projects for the City. It allocates the resources, and sets the priorities for all of the programs offered by the City. Thus, it is an integral part of making Carlsbad a wonderful community in which to live, work, and play. In addition, the budget is a fiscally conservative balanced budget, to effectively sustain the community and essential City services far into the future.

ECONOMIC PROFILE

The **US economy** has experienced steady growth over the past several years, however a slow down is expected in late 2006 and early 2007. According to preliminary estimates released by the Bureau of Economic Analysis, real gross domestic product – a measure of economic activity – increased 4.8 percent in the first quarter of 2006. In the fourth quarter of 2005, real GDP increased



1.7 percent. The major contributors to the increase in real GDP in the first quarter were consumer spending, including spending on vehicles, business investment in equipment and software, federal government spending and increased exports.

Despite the steady growth in GDP for the first quarter of 2006, UCLA Anderson Forecast's Senior Economist David Shulman expects the economy to slow due to higher interest rates, a relatively flat yield curve, weakness in the housing sector and continued pressure of higher energy prices on consumer spending. Given this expectation, the UCLA Forecast projects that the real GDP growth for 2006, 2007 and 2008 will be 3.2%, 2.4% and 3.2% respectively.

The UCLA Forecast is projecting that the housing boom is slowing and is expecting a soft landing. According to UCLA Forecast, both statistical and anecdotal data suggests that the housing market is cooling due to higher interest rates and exhaustion of demand. The international risks to the UCLA Forecast include the price and availability of oil, as well as the end of the zero interest rate policy of Japan. As the interest rates of Japan's money supply are increased and the supply of money is tightened, there is no longer "free money" which could potentially result in fewer investments as well as higher interest rates worldwide.

California's economy is also showing signs of softening. According to UCLA Forecast's Senior Economist Christopher Thornberg, housing and jobs are two areas that are of concern. Both sales of homes, as well as residential building permits, are beginning to fall, and the appreciation of housing is slowing. In addition, the Senior Economist expects reduced home appreciation, which is expected to slow taxable sales growth as consumers begin to spend less. Job losses in the construction sector as residential construction and remodeling slow, will also impact the real estate and mortgage banking industries. It appears that although UCLA Forecast predicts that jobs may not be increasing, they see indications that the output of manufacturing jobs is continuing to rise. During 2004, real output in manufacturing in the State was at an all time high. In addition, international exports from the state continues to grow at a solid pace. In 2005, estimates are that \$116 billion in manufactured exports were shipped out of California, led by computer and transportation equipment and machinery.

According to the UCLA Forecast, personal income in California grew by 4.5% in 2005, for the second year in a row. However, while personal income is growing, take home pay has not grown, due to the cost of worker benefits such as health and other forms of insurance, pension plans, and workers' compensation insurance. These benefits have been growing at well over twice the pace of overall payroll earnings according to UCLA's Senior Economist Thornberg. The offsetting adjustment to these benefit increases is slower growth in take-home pay. While take home paying is slowing, growth in taxable sales has been up by 7.5% per year for the last two fiscal years which may be due to the housing boom.

The median price of a home in California increased from \$225,000 in 2001 to over \$450,000 today. This increase in value gave Californians a boost in their income, allowing them to spend more than they were earning. As the housing industry softens, UCLA Forecast predicts that taxable sales growth will slow as more Californians begin to save. With respect to California, UCLA Forecast suggests to, "Look for weak growth starting by the end of this year and lasting for up to two years."

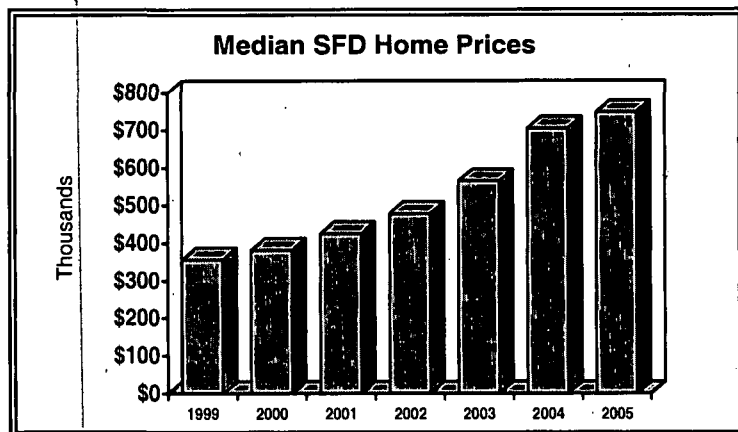
Locally, the **San Diego economy** is expected to slow as well, according to several local economists, including USD economist Alan Gin and Chief Economist for the California Association of Realtors, Leslie Appleton-Young. When asked about the San Diego housing market, Alan Nevin, chief economist for the California Building Industry Association said, "I think the bloom is off the rose, but there is no doom and gloom." Several local economists agree that despite rising interest rates, a growing inventory of houses for sale, and a slowing number of houses selling, the county's shortage of housing will prevent prices from dropping steeply. They also cautioned that with the new lending products that allowed middle-wage consumers to attain financing for high-priced homes, there may be a small increase in foreclosures and delinquencies.

USD economist Alan Gin said, "The County's overall economy would outperform the State and the rest of the nation in 2006." Gin also said he was "concerned that most of the jobs being created here offered modest salaries". He also cited rising interest rates and high gasoline prices as concerns for local consumers. "Even so, the housing market will cool but not collapse", he predicted.

Carlsbad's economy is tied closely to that of the San Diego region, although development patterns may differ. Carlsbad experienced strong growth in FY 2005-06 in property and Transient Occupancy Taxes (TOT). Property taxes are expected to grow by over 12% reflecting the continued escalation in housing prices during FY 2005-06 as well as new development. TOT, the City's gauge of the tourism industry, are expected to end the year showing a 10% gain, with a large part of that coming from the reopening of a major portion of one of Carlsbad's premiere resorts. Sales taxes should add an additional \$1 million for FY 2005-06 due to good consumer demand after taking into consideration the closing of the Robinsons-May department store at Plaza Camino Real, as well as a slowing in car sales.

Carlsbad's residential real estate market has continued strong throughout FY 2005-06. The City expects to issue approximately 1,000 residential permits this year, a decrease from the 1,663 in the previous year. The number of permits is expected to decline due to a lack of supply and a slowing economy. There are a number of new residential communities under construction or in the final phases of development that will add significantly to the residential housing stock in Carlsbad. Home sales are well under way in the Calavera Hills project in northeast Carlsbad, with 331 single-family homes and 358 multi-family units planned. The Villages of La Costa projects known as the Oaks, the Greens and the Ridge are under construction, and will add approximately 970 single-family and 450 multi-family units. The Bressi Ranch area is also under construction, with 523 single-family and 100 multi-family units to be developed. And finally, the Robertson Ranch area, which is expected to contain over 1,000 residential units, is

finishing up its master plan. The completion of these master planned communities will signal an end to the large-scale residential developments in Carlsbad.



With supply relatively low, housing prices have continued to escalate. The median price for single-family homes in Carlsbad was \$748,000 for calendar year 2005, a 5.7% increase from the previous year. The total assessed values in the City stand at over \$17 billion; an increase of nearly 70% over what they were just five years ago. With the new developments mentioned earlier starting to sell this year, the City has projected it will add about 2,580 more residential units and an additional 4.1

million square feet of commercial/industrial development over the next five years. The City's residential housing stock is about 89% built out, with approximately 5,270 housing units remaining to develop.

Commercial and industrial development has been averaging \$800,000 square feet per year. This is expected to remain about the same over the next five years to average 820,000 square feet per year with the large industrial developments of the Forum, Carlsbad Raceway, and Oaks North. Some of the major companies in town include the Gemological Institute of America, ViaSat, Invitrogen, Callaway, Taylor Made, Upper Deck, and many others.

Commercial development has brought much needed entertainment and shopping venues to citizens and visitors alike, as well as generating additional sales taxes to help pay for City services. Carlsbad is home to Car Country Carlsbad – an auto mall; the Carlsbad Premium Outlets – a specialty outlet center; Plaza Camino Real – a regional shopping mall; a Costco center; and the most recent addition; the Forum at Carlsbad - a commercial center with upscale retail shops, restaurants and other commercial uses.

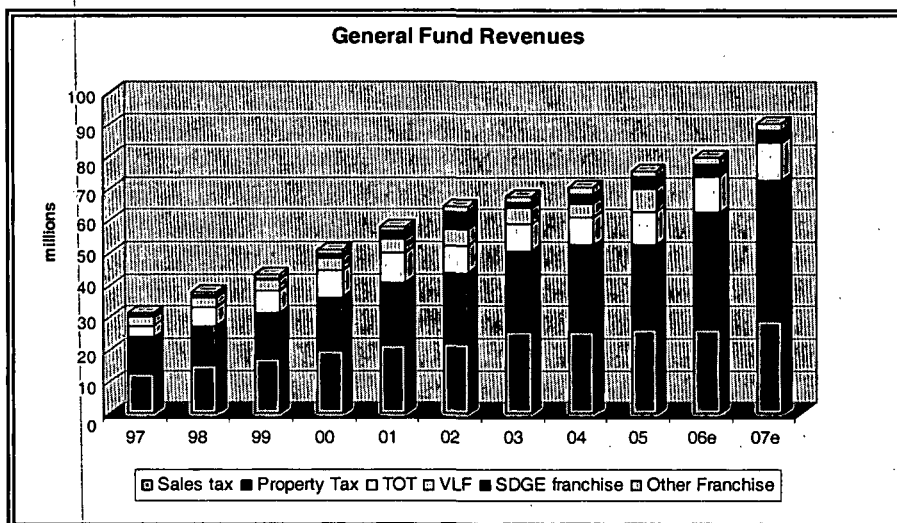
Development has also enhanced Carlsbad's reputation as a destination resort for tourism. The City is host to a major family theme park: Legoland, and has two luxury resorts available for its visitors: the Four Seasons Resort at Aviara and the La Costa Resort & Spa. There are also a number of other quality hotels and motels in the City, with the most recent addition being the West Hotel, which is expected to open in spring 2006, bringing the total available hotel rooms in the City to about 3,500.

For the future, there are several new tourist-serving projects in development. The La Costa Resort received approval to develop up to 197 commercial resort villas on their site. These are expected to be phased in over the next several years, adding over \$1.4 million in TOT when completed. Two hotels near the airport have been approved, which would add an additional 249 hotel rooms, bringing in an estimated \$500,000 per year in TOT. In addition, a new project next to Legoland has been approved for 350 hotel rooms and 350 timeshare units. This project will also be phased in over time, and is expected to generate an additional \$1.4 - \$1.7 million per year in TOT.

It is the Council's goal to ensure that the City remains in good financial health, and there are a number of steps the City has taken to attain that goal. One of these is the Growth Management Plan. This plan was adopted by the citizens to ensure that all necessary public facilities were constructed along with development. It also ensures that a financing plan is in place to pay for the facilities prior to the development of the property.

In addition to the Growth Management Plan, the City also prepares a long-term financial model for both the capital and operating needs of the City. With a growing city such as Carlsbad, it is imperative that we plan for the impacts of serving new development and operating new public facilities, as well as planning for the capital needed to build them. Thus, the City prepares a ten-year operating forecast for the General Fund, and a 20+ year Capital Improvement Program. As part of the Capital Improvement Program, the City annually calculates the amounts needed to pay for the various projects, and calculates the anticipated operating budget impacts. In this way, we can anticipate the effects of development from both a capital and an operating perspective.

One important initiative the City has undertaken to ensure its financial health, is the development of an Infrastructure Replacement Fund. With this fund, the City sets aside money on an annual basis for major maintenance and replacement of its infrastructure. Much of the City's infrastructure is relatively new; thus, the City has not felt the full impact of maintenance. By setting aside funds now, the citizens of Carlsbad can be assured that the proper maintenance and replacement, when needed, will be performed on streets, parks, and many facilities for which the City is responsible.



Carlsbad's current economic position is an enviable one. A relatively healthy local economy over the past ten years provided additional revenue-generating sites that allow the City to continue to add new facilities and services for the citizens. The City hosts three regional shopping areas within its boundaries: a large regional mall, an outlet

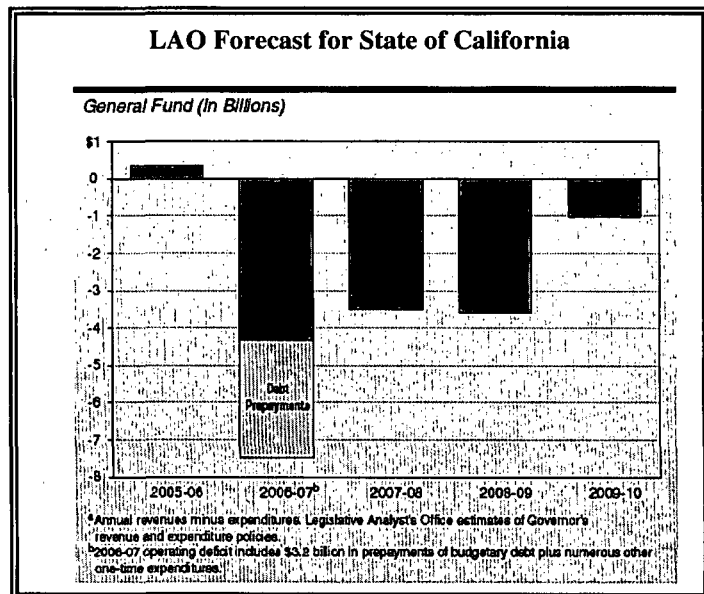
center and, the latest development, a high-end retail center in the southern part of town called The Forum. Together, these sites contribute approximately \$4.5 million annually to the City's sales taxes. The City's Auto Mall generates another \$6.5 million per year in sales taxes for the City. Legoland, a family theme park, contributes to the City's sales tax base and stimulates the development of new hotels in the area. The effect of the new development and the demand for housing in Carlsbad, is an increasing tax base. The four major revenue sources for the City: property taxes, sales taxes, transient occupancy taxes (TOT) and franchise taxes, are expected to provide \$79 million, or 77%, of the City's General Fund revenues in FY 2005-06. These taxes and fees are the major source of funding for most of the City's services, and allow the City to live up to its reputation as one of the premier locations in San Diego County.

The City's base sales taxes are projected to grow by 4.0%, while year-over-year sales tax growth is projected to grow by about 9.2% for FY 2006-07, due to one time adjustments during FY 2005-06. While the growth in housing prices is expected to moderate as interest rates rise, there is a lag with the property tax revenue and therefore, according to the County Assessor, the City should expect assessed values increasing 15.2%. New building permits are predicted to slow slightly as new housing developments come on line, but absorption rates drag out. And finally, tourism is expected to continue to be strong, with TOT receipts projected to grow by 6% in the future, with the addition of more available rooms. More information on all of the City's revenues and programs can be found in the later sections of this document.



In addition to the risk of the softening in the housing market or a slow down in the economy, the state of California's fiscal problems also cast a shadow on the City's economic future. The state of California has been in a severe fiscal crisis for a number of years. Through a variety of loans, one-time revenues, interfund borrowings and raids on city, county and special district funds, it has been able to manage its cash flows and stay solvent. However, more drastic measures will be needed for the State to finally get its budget in balance.

According to the Legislative Analyst's Office (LAO), the State is facing significant deficits in future years despite the stronger revenues seen in the past several months. The LAO's report states that the Governor's budget proposal for 2006-07 is using a significant portion of their fund balance to cover their operating shortfall, and a \$3 to 4 billion shortfall is expected to exist in FY 2007-08 and 2008-09. The ongoing budget shortfalls result from the high reliance in the near term on one-time savings and loans that will need to be repaid in the future. The State has balanced its budget by taking City money in the past, and the risk is that they may find a way to make it happen again.



In FY 2003-04, the State took approximately \$1.5 million in Vehicle License Fees from the City's General Fund with the promise to pay it back in the future. The repayment was made in FY 2005-06. In November 2003, a ballot measure was passed authorizing what is known as the "Triple Flip". This is a complicated method of securing payment for the Deficit Reduction Bonds, issued by the State to balance their budget. It is essentially a temporary swap of a ¼ cent of the cities' sales tax in return for property tax. It should have no effect on the amount of tax revenues the cities receive, but it will result in the loss of some interest earnings due to the delay in the timing of the receipt of the taxes.

As a result of the continued attacks on cities revenues, a coalition of cities, counties and special districts got a measure placed on the November 2004 ballot to put some protections in place for local governments. The measure was approved by the voters and included the following provisions:

- Permanently reducing the vehicle license fee (VLF) rate to its current .65%, and provide property taxes to cities and counties to offset the loss on a dollar for dollar basis.
- Guaranteed repayment in fiscal year '07 of the of VLF amounts taken by the State.
- Guarantees that the "Triple Flip" will be reversed when the bonds are repaid.
- Prevents the Legislature from reducing the combined property tax shares of cities, special districts, and the county, except to borrow the funds on a temporary basis to address a "severe state fiscal hardship".
- Provides for mandate relief if the State does not pay the mandated costs.

In order to garner support for the measure, cities, counties and special districts agreed to a contribution to the State totaling \$1.3 billion in both the '05 and '06 fiscal years from cities, counties and special districts. The City of Carlsbad's contribution was \$1.8 million from the

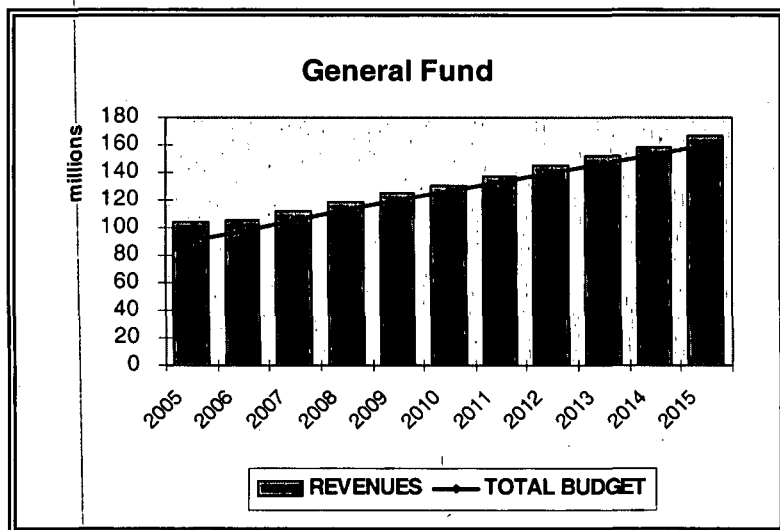
General Fund and \$293,000 from its Redevelopment Agency in Fiscal Years 2004-05 and 2005-06. The \$1.8 million is anticipated to be restored to the City in FY 2006-07.

Looking Forward

As stated earlier in this document, the City prepares ten-year forecasts for the General Fund each year in order to understand the effects of actions taken today on the City's future. The City has experienced remarkable revenue growth over the past ten years due to the development of the majority of its commercial sites. The future will bring a few more commercial sites but at a slower pace, while residential development will continue for a number of years. There are also quite a few City facilities – mainly parks and civic facilities – planned in the future to serve the growing population. The new facilities will add operating costs to the City's General Fund budget as they are completed and opened for use.

These factors alone will cause the General Fund costs to escalate at a higher rate than inflation. In addition, a number of other factors – mainly rising retirement and health care costs – have created upward pressure on expenditures, especially over the past several years. These factors have been incorporated into the General Fund forecast shown below and projected over the next ten years. While no forecast is ever totally accurate, it does represent a likely scenario given the assumptions on which it is built.

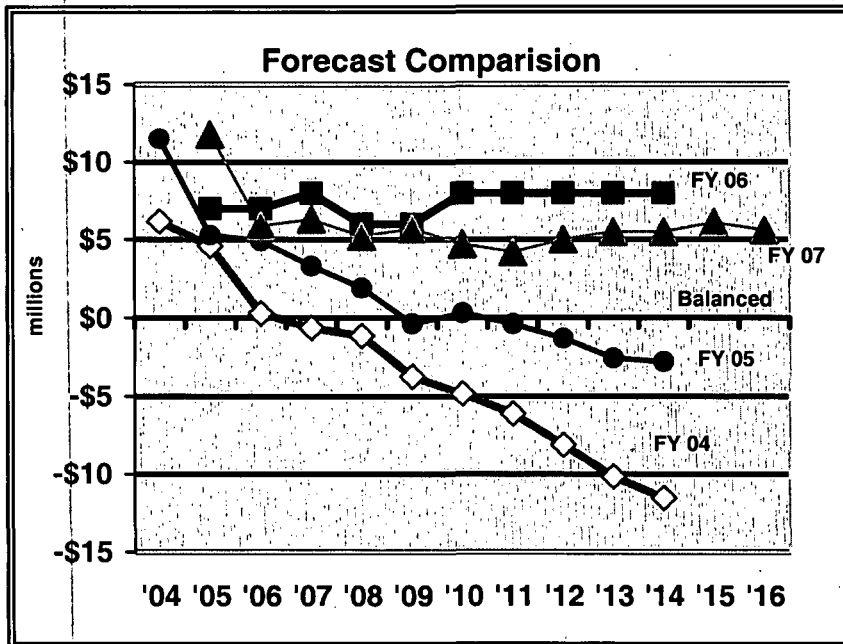
This forecast assumes that revenue growth will continue at a moderate pace in 2006-07 and into the future. To project the expenditures, it includes all known personnel costs, most of which have been negotiated with the employee groups. The City has multi-year agreements with most of the major employee groups and is expected to negotiate a new contract with the Carlsbad Firefighters' Association in FY 2006-07.



The forecast assumes 15% increases in health care costs in the near future, slowing to 5% in the future. It also assumes personnel growth (new positions) to remain rather flat at no more than 2% per year. Cost of living increases between 3 and 5% have been added to personnel costs. Pension plan costs are anticipated to remain essentially at current levels. It assumes that the contribution from the General Fund to the Infrastructure Replacement Fund is increased to 6.5% General Fund revenues.

This is an increase from last year's forecast assumption of 4% in FY 2007 and 5% from FY 2008 and beyond. And finally, it includes estimated operating costs for all capital projects in the timeframes shown in the Capital Improvement Program (CIP). One of the biggest assumptions in the forecast is that services remain the same. No new services have been anticipated, although growth in current services to match the growing population has been incorporated.

The results show that the General Fund is balanced into the future, with a slight surplus in each year of less than 5%. This achieves the goal set out by Council to maintain a balanced budget.



The situation was different just a couple of years ago when the forecast projected that the City was headed for deficits unless corrective measures were taken. For the past two years, Council and staff have worked to bring the forecast back into balance. Through a combination of enhancing revenue sources and finding more efficient methods of providing services (and with the help of a strong local economy), the City was able to turn the forecast around from heading into deficits to a healthy balance.

One of the more significant revenue enhancements that occurred in November 2004 was the passage of the reauthorization of Transnet revenues. Transnet is a ¼ cent additional sales tax collected countywide and used to improve the transportation systems. The current authorization for the sales tax was to end in 2008. SANDAG, the San Diego Association of Governments, placed a measure on the November 2004 ballot to reauthorize the sales tax for another 40 years. The measure passed, providing the City \$1.5 million in annual taxes to be spent on street repair, maintenance and construction.

The ability to understand the future impacts of both changes in revenue sources as well as program needs, is crucial to ensure that the City has the funds available to make its future plans come true. The General Fund forecast is a tool available to the City to achieve the goal of managing its fiscal resources effectively and monitoring the achievement of sustainable economic health for the City of Carlsbad.